

How The Federal Reserve Creates Money From Thin Air The Mandrake Mechanism

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Bull Not Bull on February 9, 2006.

THE MANDRAKE MECHANISM . . . *The method by which the Federal Reserve creates money out of nothing; the concept of usury as the payment of interest on pretended loans; the true cause of the hidden tax called inflation; the way in which the Fed creates boom-bust cycles.*

In the 1940s, there was a comic strip character called Mandrake the Magician. His specialty was creating things out of nothing and, when appropriate, to make them disappear back into that same void. It is fitting, therefore, that the process to be described in this section should be named in his honor.

In the previous chapters, we examined the technique developed by the political and monetary scientists to create money out of nothing for the purpose of lending. This is not an entirely accurate description because it implies that money is created first and then waits for someone to borrow it.

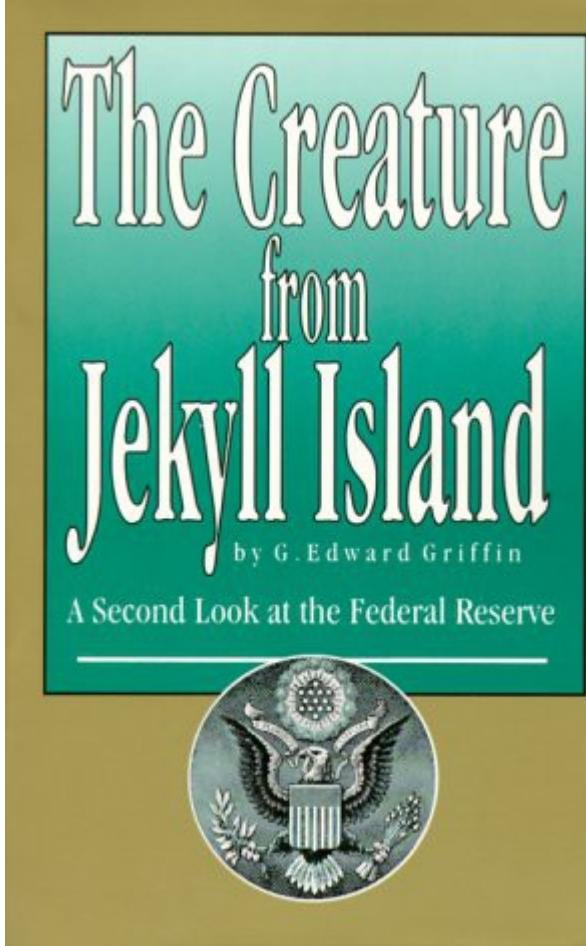
On the other hand, textbooks on banking often state that money is created out of debt. This also is misleading because it implies that debt exists first and then is converted into money. In truth, money is not created until the instant it is borrowed. It is the act of borrowing which causes it to spring into existence. And, incidentally, it is the act of paying off the debt that causes it to vanish. There is no short phrase that perfectly describes that process. So, until one is invented along the way, we shall continue using the phrase "create money out of nothing" and occasionally add "for the purpose of lending" where necessary to further clarify the meaning. So, let us now . . . see just how far this money/debt-creation process has been carried -- and how it works.

The first fact that needs to be considered is that our money today has no gold or silver behind it whatsoever. The fraction is not 54% nor 15%. It is 0%. It has traveled the path of all previous fractional money in history and already has degenerated into pure fiat money. The fact that most of it is in the form of checkbook balances rather than paper currency is a mere technicality; and the fact that bankers speak about "reserve ratios" is eyewash. The so-called reserves to which they refer are, in fact, Treasury bonds and other certificates of debt. Our money is "pure fiat" through and through.

The second fact that needs to be clearly understood is that, in spite of the technical jargon and seemingly complicated procedures, the actual mechanism by which the Federal Reserve creates money

THE FEDERAL RESERVE'S Mandrake Mechanism





is quite simple. They do it exactly the same way the goldsmiths of old did except, of course, the goldsmiths were limited by the need to hold some precious metals in reserve, whereas the Fed has no such restriction.

THE FEDERAL RESERVE IS CANDID

The Federal Reserve itself is amazingly frank about this process. A booklet published by the Federal Reserve Bank of New York tells us: "Currency cannot be redeemed, or exchanged, for Treasury gold or any other asset used as backing. The question of just what assets 'back' Federal Reserve notes has little but bookkeeping significance."

Elsewhere in the same publication we are told: "Banks are creating money based on a borrower's promise to pay (the IOU) . . . Banks create money by 'monetizing' the private debts of businesses and individuals."

In a booklet entitled *Modern Money Mechanics*, the Federal Reserve Bank of Chicago says:
In the United States neither paper currency nor deposits have value as commodities. Intrinsically, a dollar bill is just a piece of paper. Deposits are merely book entries. Coins do have some

intrinsic value as metal, but generally far less than their face amount.

What, then, makes these instruments -- checks, paper money, and coins -- acceptable at face value in payment of all debts and for other monetary uses? Mainly, it is the confidence people have that they will be able to exchange such money for other financial assets and real goods and services whenever they choose to do so. This partly is a matter of law; currency has been designated "legal tender" by the government -- that is, it must be accepted.

In the fine print of a footnote in a bulletin of the Federal Reserve Bank of St. Louis, we find this surprisingly candid explanation:

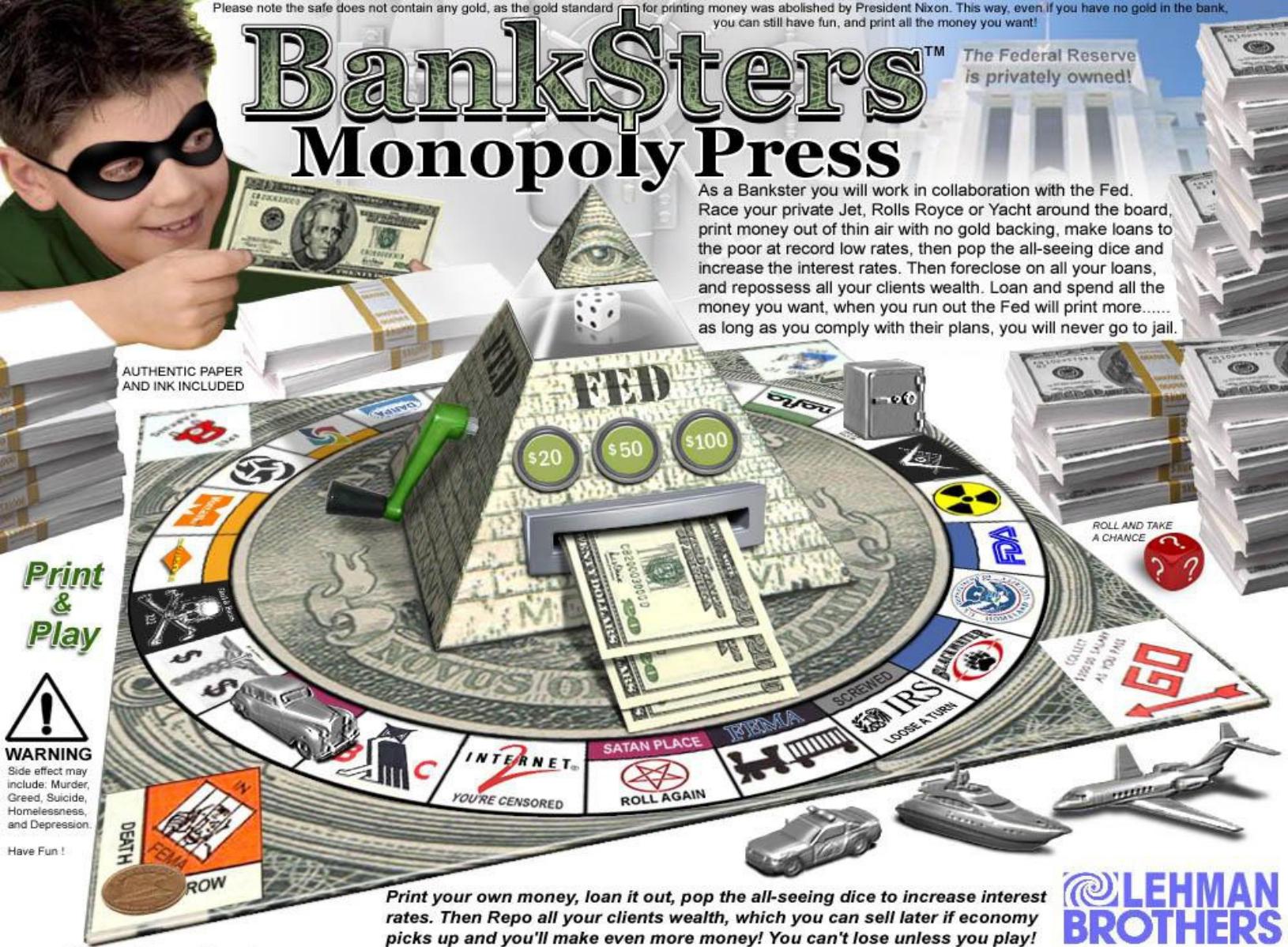
Modern monetary systems have a fiat base -- literally money by decree -- with depository institutions, acting as fiduciaries, creating obligations against themselves with the fiat base acting in part as reserves. The decree appears on the currency notes: "This note is legal tender for all debts, public and private." While no individual could refuse to accept such money for debt repayment, exchange contracts could easily be composed to thwart its use in everyday commerce. However, a forceful explanation as to why money is accepted is that the federal government requires it as payment for tax liabilities. Anticipation of the need to clear this debt creates a demand for the pure fiat dollars.

MONEY WOULD VANISH WITHOUT DEBT

It is difficult for Americans to come to grips with the fact that their total money-supply is backed by nothing but debt, and it is even more mind boggling to visualize that, if everyone paid back all that was borrowed, there would be no money left in existence.

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That's right, there would not be one penny in circulation -- all coins and all paper currency would be returned to bank vaults -- and there would be not one dollar in any one's checking account. In short, all money would disappear.

Marriner Eccles was the Governor of the Federal Reserve System in 1941. On September 30 of that year, Eccles was asked to give testimony before the House Committee on Banking and Currency. The purpose of the hearing was to obtain information regarding the role of the Federal Reserve in creating conditions that led to the depression of the 1930s.

Congressman Wright Patman, who was Chairman of that committee, asked how the Fed got the money to purchase two billion dollars worth of government bonds in 1933. This is the exchange that followed.

Eccles: We created it.

Patman: Out of what?

Eccles: Out of the right to issue credit money.

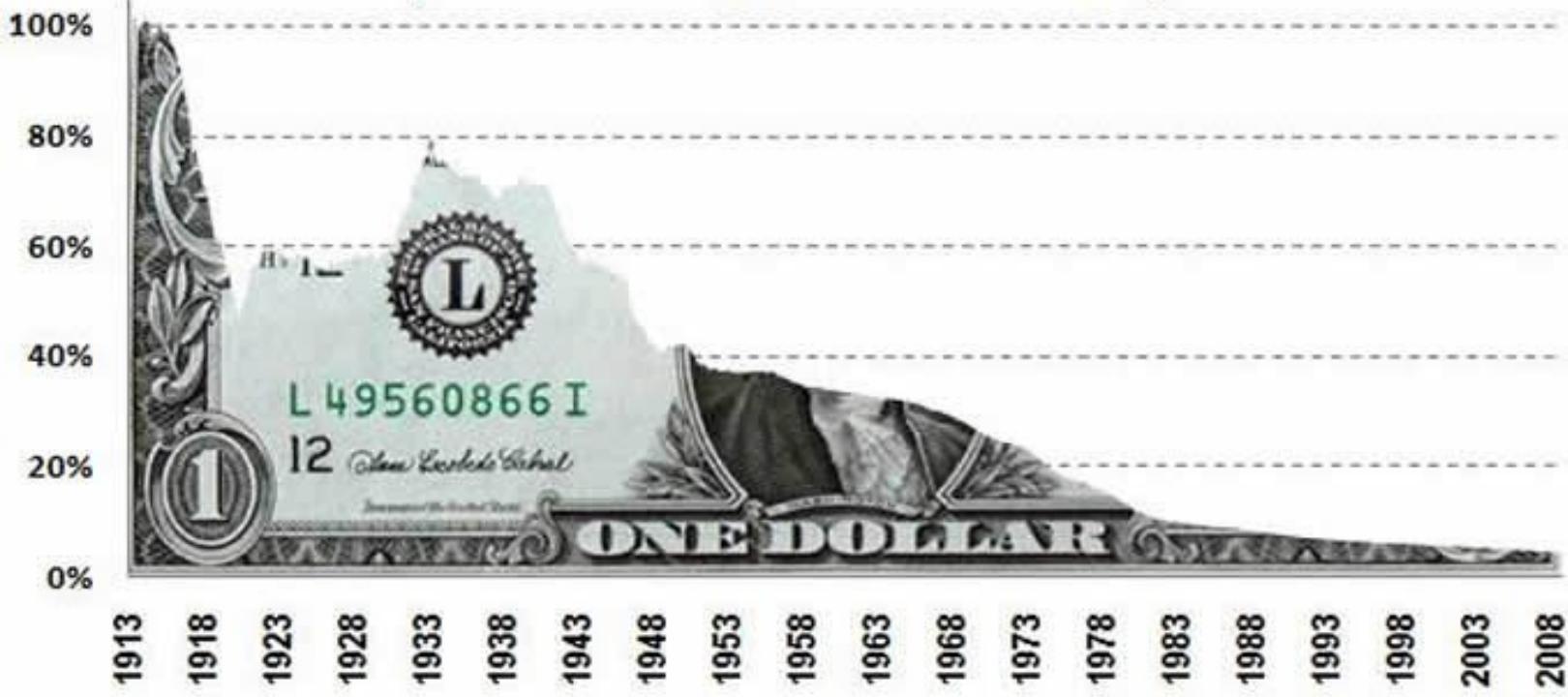
Patman: And there is nothing behind it, is there, except our government's credit?

Eccles: That is what our money system is. If there were no debts in our money system, there wouldn't be any money.

**LEHMAN
BROTHERS**

USD Purchasing Power Since 1913

(Source: Bureau of Labor Statistics)



It must be realized that, while money may represent an asset to selected individuals, when it is considered as an aggregate of the total money supply, it is not an asset at all. A man who borrows \$1,000 may think that he has increased his financial position by that amount but he has not. His \$1,000 cash asset is offset by his \$1,000 loan liability, and his net position is zero. Bank accounts are exactly the same on a larger scale. Add up all the bank accounts in the nation, and it would be easy to assume that all that money represents a gigantic pool of assets which support the economy. Yet, every bit of this money is owed by someone. Some will owe nothing. Others will owe many times what they possess. All added together, the national balance is zero. What we think is money is but a grand illusion. The reality is debt.

Robert Hemphill was the Credit Manager of the Federal Reserve Bank in Atlanta. In the foreword to a book by Irving Fisher, entitled 100% Money, Hemphill said this:

If all the bank loans were paid, no one could have a bank deposit, and there would not be a dollar of coin or currency in circulation. This is a staggering thought. We are completely dependent on the commercial banks. Someone has to borrow every dollar we have in circulation, cash, or credit. If the banks create ample synthetic money we are prosperous; if not, we starve. We are absolutely without a permanent money system. When one gets a complete grasp of the picture, the tragic absurdity of our hopeless situation is almost incredible -- but there it is.

With the knowledge that money in America is based on debt, it should not come as a surprise to learn that the Federal Reserve System is not the least interested in seeing a reduction in debt in this country, regardless of public utterances to the contrary. Here is the bottom line from the System's own publications. The Federal Reserve Bank of Philadelphia says:

"A large and growing number of analysts, on the other hand, now regard the national debt as something useful, if not an actual blessing . . . [They believe] the national debt need not be reduced at all."

The Federal Reserve Bank of Chicago adds: "Debt -- public and private -- is here to stay. It plays an



essential role in economic processes . . . What is required is not the abolition of debt, but its prudent use and intelligent management."

WHAT'S WRONG WITH A LITTLE DEBT?

There is a kind of fascinating appeal to this theory. It gives those who expound it an aura of intellectualism, the appearance of being able to grasp a complex economic principle that is beyond the comprehension of mere mortals. And, for the less academically minded, it offers the comfort of at least sounding moderate. After all, what's wrong with a little debt, prudently used and intelligently managed? The answer is nothing, provided the debt is based on an honest transaction. There is plenty wrong with it if it is "based upon fraud".



REAL UNITED STATES MONEY BACKED BY GOLD FROM THE TREASURY END THE FED



A REAL UNITED STATES DOLLAR BACKED BY SILVER THIS IS REAL MONEY FROM THE TREASURY END THE FEDERAL RESERVE NOW!!!

An honest transaction is one in which a borrower pays an agreed upon sum in return for the temporary use of a lender's asset. That asset could be anything of tangible value. If it were an automobile, for example, then the borrower would pay "rent." If it is money, then the rent is called "interest." Either way, the concept is the same.

When we go to a lender -- either a bank or a private party -- and receive a loan of money, we are willing to pay interest on the loan in recognition of the fact that the money we are borrowing is an asset which we want to use. It seems only fair to pay a rental fee for that asset to the person who owns it. It is not easy to acquire an automobile, and it is not easy to acquire money -- real money, that is. If the money we are borrowing was earned by someone's labor and talent, they are fully entitled to receive interest on it. But what are we to think of money that is created by the mere stroke of a pen or the click of a computer key? Why should anyone collect a rental fee on that?

When banks place credits into your checking account, they are merely pretending to lend you money.

END THE FED

SOUND MONEY FOR AMERICA

In reality, they have nothing to lend. Even the money that non-indebted depositors have placed with them was originally created out of nothing in response to someone else's loan. So what entitles the banks to collect rent on nothing? It is immaterial that men everywhere are forced by law to accept these nothing certificates in exchange for real goods and services. We are talking here, not about what is legal, but what is moral. As Thomas Jefferson observed at the time of his protracted battle against central banking in the United States, "No one has a natural right to the trade of money lender, but he who has money to lend."

THIRD REASON TO ABOLISH THE SYSTEM (see the book for all seven reasons)

Centuries ago, usury was defined as any interest charged for a loan. Modern usage has redefined it as excessive interest. Certainly, any amount of interest charged for a pretended loan is excessive. The dictionary, therefore, needs a new definition. Usury: *The charging of any interest on a loan of fiat money.*

Let us, therefore, look at debt and interest in this light. Thomas Edison summed up the immorality of the system when he said:

People who will not turn a shovel of dirt on the project [Muscle Shoals] nor contribute a pound of materials will collect more money . . . than will the people who will supply all the materials and do all the work.

Is that an exaggeration? Let us consider the purchase of a \$100,000 home in which \$30,000 represents the cost of the land, architect's fee, sales commissions, building permits, and that sort of thing and \$70,000 is the cost of labor and building materials. If the home buyer puts up \$30,000 as a down payment, then \$70,000 must be borrowed. If the loan is issued at 11% over a 30-year period, the amount of interest paid will be \$167,806. That means the amount paid to those who loan the money is about 2 1/2 times greater than paid to those who provide all the labor and all the materials. It is true that this figure represents the time-value of that money over thirty years and easily could be justified on the basis that a lender deserves to be compensated for surrendering the use of his capital for half a lifetime. But that assumes the lender actually had something to surrender, that he had earned the capital, saved it, and then loaned it for construction of someone else's house. What are we to think, however, about a lender who did nothing to earn the money, had not saved it, and, in fact, simply created it out of thin air? What is the time-value of nothing?

As we have already shown, every dollar that exists today, either in the form of currency, checkbook money, or even credit card money -- in other words, our entire money supply -- exists only because it was borrowed by someone; perhaps not you, but someone.

That means all the American dollars in the entire world are earning daily and compounding interest for the banks which created them. A portion of every business venture, every investment, every profit, every transaction which involves money -- and that even includes losses and the payment of taxes -- a portion of all that is earmarked as payment to a bank.

The Last President that Tried to



And what did the banks do to earn this perpetually flowing river of wealth? Did they lend out their own capital obtained through investment of stockholders? Did they lend out the hard-earned savings of their depositors? No, neither of these were their major source of income. They simply waved the magic wand called fiat money.

The flow of such unearned wealth under the guise of interest can only be viewed as usury of the highest magnitude. Even if there were no other reasons to abolish the Fed, the fact that it is the supreme instrument of usury would be more than sufficient by itself.

WHO CREATES THE MONEY TO PAY THE INTEREST?

One of the most perplexing questions associated with this process is "Where does the money come from to pay the interest?" If you borrow \$10,000 from a bank at 9%, you owe \$10,900. But the bank only manufactures \$10,000 for the loan. It would seem, therefore, that there is no way that you -- and all others with similar loans -- can possibly pay off your indebtedness. The amount of money put into circulation just isn't enough to cover the total debt, including interest. This has led some to the conclusion that it is necessary for you to borrow the \$900 for interest, and that, in turn, leads to still more interest. The assumption is that, the more we borrow, the more we have to borrow, and that debt based on fiat money is a never ending spiral leading inexorably to more and more debt.

This is a partial truth. It is true that there is not enough money created to include the interest, but it is a fallacy that the only way to pay it back is to borrow still more. The assumption fails to take into account the exchange value of labor. Let us assume that you pay back your \$10,000 loan at the rate of approximately \$900 per month and that about \$80 of that represents interest. You realize you are hard pressed to make your payments so you decide to take on a part-time job.

The bank, on the other hand, is now making \$80 profit each month on your loan. Since this amount is

classified as "interest," it is not extinguished as is the larger portion which is a return of the loan itself. So this remains as spendable money in the account of the bank. The decision then is made to have the bank's floors waxed once a week. You respond to the ad in the paper and are hired at \$80 per month to do the job. The result is that you earn the money to pay the interest on your loan, and -- this is the point -- the money you receive is the same money which you previously had paid. As long as you perform labor for the bank each month, the same dollars go into the bank as interest, then out of the revolving door as your wages, and then back into the bank as loan repayment.

It is not necessary that you work directly for the bank. No matter where you earn the money, its origin was a bank and its ultimate destination is a bank. The loop through which it travels can be large or small, but the fact remains all interest is paid eventually by human effort. And the significance of that fact is even more startling than the assumption that not enough money is created to pay back the interest. It is that the total of this human effort ultimately is for the benefit of those who create fiat money.

It is a form of modern serfdom in which the great mass of society works as indentured servants to a ruling class of financial nobility.

UNDERSTANDING THE ILLUSION

That's really all one needs to know about the operation of the banking cartel under the protection of the Federal Reserve. But it would be a shame to stop here without taking a look at the actual cogs, mirrors, and pulleys that make the magical mechanism work. It is a truly fascinating engine of mystery and deception.

Let us, therefore, turn our attention to the actual process by which the magicians create the illusion of modern money. First we shall stand back for a general view to see the overall action.

Then we shall move in closer and examine each component in detail.

THE MANDRAKE MECHANISM: AN OVERVIEW:

DEBT

The entire function of this machine is to convert debt into money. It's just that simple. First, the Fed takes all the government bonds which the public does not buy and writes a check to Congress in exchange for them. (It acquires other debt obligations as well, but government bonds comprise most of its inventory.) There is no money to back up this check. These fiat dollars are created on the spot for that purpose. By calling those bonds "reserves," the Fed then uses them as the base for creating nine (9) additional dollars for every dollar created for the bonds themselves. The money created for the bonds is spent by the government, whereas the money created on top of those bonds is the source of all the bank loans made to the nation's businesses and individuals. The result of this process is the same as creating money on a printing press, but the illusion is based on an accounting trick rather than a printing trick.

The bottom line is that Congress and the banking cartel have entered into a partnership in which the cartel has the privilege of collecting interest on money which it creates out of nothing, a perpetual override on every American dollar that exists in the world.

Congress, on the other hand, has access to unlimited funding without having to tell the voters their taxes are being raised through the process of inflation. If you understand this paragraph, you

understand the Federal Reserve System.

MONEY

Now for a more detailed view. There are three general ways in which the Federal Reserve creates fiat money out of debt.

One is by making loans to the member banks through what is called the Discount Window.

The second is by purchasing Treasury bonds and other certificates of debt through what is called the Open Market Committee.

The third is by changing the so-called reserve ratio that member banks are required to hold. Each method is merely a different path to the same objective: taking IOUs and converting them into spendable money.

THE DISCOUNT WINDOW

The Discount Window is merely bankers' language for the loan window. When banks run short of money, the Federal Reserve stands ready as the "bankers' bank" to lend it. There are many reasons for them to need loans. Since they hold "reserves" of only about one or two per cent of their deposits in vault cash and eight or nine per cent in securities, their operating margin is extremely thin. It is common for them to experience temporary negative balances caused by unusual customer demand for cash or unusually large clusters of checks all clearing through other banks at the same time. Sometimes they make bad loans and, when these former "assets" are removed from their books, their "reserves" are also decreased and may, in fact, become negative. Finally, there is the profit motive. When banks borrow from the Federal Reserve at one interest rate and lend it out at a higher rate, there is an obvious advantage. But that is merely the beginning. When a bank borrows a dollar from the Fed, it becomes a one-dollar reserve.

Since the banks are required to keep reserves of only about ten per cent, they actually can loan up to nine dollars for each dollar borrowed.

Let's take a look at the math. Assume the bank receives \$1 million from the Fed at a rate of 8%. The total annual cost, therefore, is \$80,000 (.08 X \$1,000,000). The bank treats the loan as a cash deposit, which means it becomes the basis for manufacturing an additional \$9 million to be lent to its customers. If we assume that it lends that money at 11% interest, its gross return would be \$990,000 (.11 X \$9,000,000). Subtract from this the bank's cost of \$80,000 plus an appropriate share of its overhead, and we have a net return of about \$900,000. In other words, the bank borrows a million and can almost double it in one year. That's leverage! But don't forget the source of that leverage: the manufacture of another \$9 million which is added to the nation's money supply.

THE OPEN MARKET OPERATION

The most important method used by the Federal Reserve for the creation of fiat money is the purchase and sale of securities on the open market. But, before jumping into this, a word of warning. Don't expect what follows to make any sense. Just be prepared to know that this is how they do it.

The trick lies in the use of words and phrases which have technical meanings quite different from what they imply to the average citizen. So keep your eye on the words. They are not meant to explain but to

deceive. In spite of first appearances, the process is not complicated. It is just absurd.

THE MANDRAKE MECHANISM: A DETAILED VIEW

Start with . . .

GOVERNMENT DEBT

The federal government adds ink to a piece of paper, creates impressive designs around the edges, and calls it a bond or Treasury note. It is merely a promise to pay a specified sum at a specified interest on a specified date. As we shall see in the following steps, this debt eventually becomes the foundation for almost the entire nation's money supply. In reality, the government has created cash, but it doesn't yet look like cash. To convert these IOUs into paper bills and checkbook money is the function of the Federal Reserve System. To bring about that transformation, the bond is given to the Fed where it is then classified as a . . .

SECURITIES ASSET

An instrument of government debt is considered an asset because it is assumed the government will keep its promise to pay. This is based upon its ability to obtain whatever money it needs through taxation. Thus, the strength of this asset is the power to take back that which it gives. So the Federal Reserve now has an "asset" which can be used to offset a liability. It then creates this liability by adding ink to yet another piece of paper and exchanging that with the government in return for the asset. That second piece of paper is a . . .

FEDERAL RESERVE CHECK

There is no money in any account to cover this check. Anyone else doing that would be sent to prison. It is legal for the Fed, however, because Congress wants the money, and this is the easiest way to get it. (To raise taxes would be political suicide; to depend on the public to buy all the bonds would not be realistic, especially if interest rates are set artificially low; and to print very large quantities of currency would be obvious and controversial.) This way, the process is mysteriously wrapped up in the banking system. The end result, however, is the same as turning on government printing presses and simply manufacturing fiat money (money created by the order of government with nothing of tangible value backing it) to pay government expenses. Yet, in accounting terms, the books are said to be "balanced" because the liability of the money is offset by the "asset" of the IOU. The Federal Reserve check received by the government then is endorsed and sent back to one of the Federal Reserve banks where it now becomes a . . .

GOVERNMENT DEPOSIT

Once the Federal Reserve check has been deposited into the government's account, it is used to pay government expenses and, thus, is transformed into many . . .

GOVERNMENT CHECKS

These checks become the means by which the first wave of fiat money floods into the economy. Recipients now deposit them into their own bank accounts where they become . . .

COMMERCIAL BANK DEPOSITS

Commercial bank deposits immediately take on a split personality.

On the one hand, they are liabilities to the bank because they are owed back to the depositors. But, as long as they remain in the bank, they also are considered as assets because they are on hand. Once again, the books are balanced: the assets offset the liabilities. But the process does not stop there. Through the magic of fractional-reserve banking, the deposits are made to serve an additional and more lucrative purpose. To accomplish this, the on-hand deposits now become reclassified in the books and called . . .

BANK RESERVES

Reserves for what? Are these for paying off depositors should they want to close out of their accounts? No. That's the lowly function they served when they were classified as mere assets. Now that they have been given the name of "reserves," they become the magic wand to materialize even larger amounts of fiat money. This is where the real action is: at the level of the commercial banks. Here's how it works. The banks are permitted by the Fed to hold as little as 10% of their deposits in "reserve." That means, if they receive deposits of \$1 million from the first wave of fiat money created by the Fed, they have \$900,000 more than they are required to keep on hand (\$1 million less 10% reserve). In bankers' language, that \$900,000 is called . . .

EXCESS RESERVES

The word "excess" is a tip off that these so-called reserves have a special destiny. Now that they have been transmuted into an "excess," they are considered as available for lending. And so in due course these excess reserves are converted into . . .

BANK LOANS

But wait a minute. How can this money be loaned out when it is owned by the original depositors who are still free to write checks and spend it any time they wish? The answer is that, when the new loans are made, they are not made with the same money at all. They are made with brand new money created out of thin air for that purpose. The nation's money supply simply increases by ninety per cent of the bank's deposits. Furthermore, this new money is far more interesting to the banks than the old. The old money, which they received from depositors, requires them to pay out interest or perform services for the privilege of using it. But, with the new money, the banks collect interest, instead, which is not too bad considering it cost them nothing to make. Nor is that the end of the process. When this second wave of fiat money moves into the economy, it comes right back into the banking system, just as the first wave did, in the form of . . .

MORE COMMERCIAL BANK DEPOSITS

The process now repeats but with slightly smaller numbers each time around. What was a "loan" on Friday comes back into the bank as a "deposit" on Monday. The deposit then is reclassified as a "reserve" and ninety per cent of that becomes an "excess" reserve which, once again, is available for a new "loan." Thus, the \$1 million of first wave fiat money gives birth to \$900,000 in the second wave, and that gives birth to \$810,000 in the third wave (\$900,000 less 10% reserve). It takes about twenty-eight times through the revolving door of deposits becoming loans becoming deposits becoming more

loans until the process plays itself out to the maximum effect, which is . . .

BANK FIAT MONEY = UP TO 9 TIMES GOVERNMENT DEBT

The amount of fiat money created by the banking cartel is approximately nine times the amount of the original government debt which made the entire process possible. When the original debt itself is added to that figure, we finally have . . .

TOTAL FIAT MONEY = UP TO 10 TIMES GOVERNMENT

The total amount of fiat money created by the Federal Reserve and the commercial banks together is approximately ten times the amount of the underlying government debt. To the degree that this newly created money floods into the economy in excess of goods and services, it causes the purchasing power of all money, both old and new, to decline. Prices go up because the relative value of the money has gone down. The result is the same as if that purchasing power had been taken from us in taxes. The reality of this process, therefore, is that it is a . . .

HIDDEN TAX = UP TO 10 TIMES THE NATIONAL DEBT

Without realizing it, Americans have paid over the years, in addition to their federal income taxes and excise taxes, a completely hidden tax equal to many times the national debt! And that still is not the end of the process. Since our money supply is purely an arbitrary entity with nothing behind it except debt, its quantity can go down as well as up. When people are going deeper into debt, the nation's money supply expands and prices go up, but when they pay off their debts and refuse to renew, the money supply contracts and prices tumble. That is exactly what happens in times of economic or political uncertainty. This alternation between period of expansion and contraction of the money supply is the underlying cause of . . .

BOOMS, BUSTS, AND DEPRESSIONS

Who benefits from all of this? Certainly not the average citizen.

The only beneficiaries are the political scientists in Congress who enjoy the effect of unlimited revenue to perpetuate their power, and the monetary scientists within the banking cartel called the Federal Reserve System who have been able to harness the American people, without their knowing it, to the yoke of modern feudalism.

RESERVE RATIOS

The previous figures are based on a "reserve" ratio of 10% (a money-expansion ratio of 10-to-1). It must be remembered, however, that this is purely arbitrary. Since the money is fiat with no previous-metal backing, there is no real limitation except what the politicians and money managers decide is expedient for the moment. Altering this ratio is the third way in which the Federal Reserve can influence the nation's supply of money. The numbers, therefore, must be considered as transient.

At any time there is a "need" for more money, the ratio can be increased to 20-to-1 or 50-to-1, or the pretense of a reserve can be dropped altogether. There is virtually no limit to the amount of fiat money that can be manufactured under the present system.

NATIONAL DEBT NOT NECESSARY FOR INFLATION

Because the Federal Reserve can be counted on to "monetize" (convert into money) virtually any amount of government debt, and because this process of expanding the money supply is the primary cause of inflation, it is tempting to jump to the conclusion that federal debt and inflation are but two aspects of the same phenomenon. This, however, is not necessarily true. It is quite possible to have either one without the other.

The banking cartel holds a monopoly in the manufacture of money. Consequently, money is created only when IOUs are "monetized" by the Fed or by commercial banks. When private individuals, corporations, or institutions purchase government bonds, they must use money they have previously earned and saved. In other words, no new money is created, because they are using funds that are already in existence. Therefore, the sale of government bonds to the banking system is inflationary, but when sold to the private sector, it is not. That is the primary reason the United States avoided massive inflation during the 1980s when the federal government was going into debt at a greater rate than ever before in its history. By keeping interest rates high, these bonds became attractive to private investors, including those in other countries. Very little new money was created, because most of the bonds were purchased with American dollars already in existence. This, of course, was a temporary fix at best.

Today, those bonds are continually maturing and are being replaced by still more bonds to include the original debt plus accumulated interest. Eventually this process must come to an end and, when it does, the Fed will have no choice but to literally buy back all the debt of the '80s -- that is, to replace all of the formerly invested private money with newly manufactured fiat money -- plus a great deal more to cover the interest. Then we will understand the meaning of inflation.

On the other side of the coin, the Federal Reserve has the option of manufacturing money even if the federal government does not go deeper into debt. For example, the huge expansion of the money supply leading up to the stock market crash in 1929 occurred at a time when the national debt was being paid off. In every year from 1920 through 1930, federal revenue exceeded expenses, and there were relatively few government bonds being offered. The massive inflation of the money supply was made possible by converting commercial bank loans into "reserves" at the Fed's discount window and by the Fed's purchase of banker's acceptances, which are commercial contracts for the purchase of goods.

Now the options are even greater. The Monetary Control Act of 1980 has made it possible for the Creature to monetize virtually any debt instrument, including IOUs from foreign governments. The apparent purpose of this legislation is to make it possible to bail out those governments which are having trouble paying the interest on their loans from American banks. When the Fed creates fiat American dollars to give foreign governments in exchange for their worthless bonds, the money path is slightly longer and more twisted, but the effect is similar to the purchase of U.S. Treasury Bonds. The newly created dollars go to the foreign governments, then to the American banks where they become cash reserves. Finally, they flow back into the U.S. money pool (multiplied by nine) in the form of additional loans. The cost of the operation once again is born by the American citizen through the loss of purchasing power. Expansion of the money supply, therefore, and the inflation that follows, no longer even require federal deficits. As long as someone is willing to borrow American dollars, the cartel will have the option of creating those dollars specifically to purchase their bonds and, by so doing, continue to expand the money supply.

We must not forget, however, that one of the reasons the Fed was created in the first place was to make it possible for Congress to spend without the public knowing it was being taxed. Americans have

shown an amazing indifference to this fleecing, explained undoubtedly by their lack of understanding of how the Mandrake Mechanism works. Consequently, at the present time, this cozy contract between the banking cartel and the politicians is in little danger of being altered. As a practical matter, therefore, even though the Fed may also create fiat money in exchange for commercial debt and for bonds of foreign governments, its major concern likely will be to continue supplying Congress.

The implications of this fact are mind boggling. Since our money supply, at present at least, is tied to the national debt, to pay off that debt would cause money to disappear. Even to seriously reduce it would cripple the economy. Therefore, as long as the Federal Reserve exists, America will be, must be, in debt. The purchase of bonds from other governments is accelerating in the present political climate of internationalism. Our own money supply increasingly is based upon their debt as well as ours, and they, too, will not be allowed to pay it off even if they are able.

TAXES NOT EVEN NECESSARY

It is a sobering thought that the federal government now could operate -- even at its current level of spending -- without levying any taxes whatsoever. All it has to do is create the required money through the Federal Reserve System by monetizing its own bonds. In fact, most of the money it now spends is obtained in that way.

If the idea of eliminating the IRS sounds like good news, remember that the inflation that results from monetizing the debt is just as much a tax as any other; but because it is hidden, and so few Americans understand how it works, it is more politically popular than a tax that is out in the open.

Inflation can be likened to a game of Monopoly in which the game's banker has no limit to the amount of money he can distribute. With each throw of the dice he reaches under the table and brings up another stack of those paper tokens, which all the players must use as money. If the banker is also one of the players -- and in our real world that is exactly the case -- obviously he is going to end up owning all the property. But, in the meantime, the increasing flood of money swirls out from the banker and engulfs the players. As the quantity of money becomes greater, the relative worth of each token becomes less, and the prices bid for the properties goes up. The game is called monopoly for a reason. In the end, one person holds all the property and everyone else is bankrupt. But what does it matter? It is only a game.

Unfortunately, it is not a game in the real world. It is our livelihood, our food, and our shelter. It does make a difference if there is only one winner, and it makes a big difference if that winner obtained his monopoly simply by manufacturing everyone's money.

FOURTH REASON TO ABOLISH THE SYSTEM

Make no mistake about it, inflation is a tax. Furthermore, it is the most unfair tax of them all because it falls most heavily upon those who are thrifty, those on fixed incomes, and those in the middle and lower income tax brackets. The important point here is that this hidden tax would be impossible without fiat money. Fiat money in America is created solely as a result of the Federal Reserve System. Therefore, it is totally accurate to say that the Federal Reserve System guarantees the most unfair tax of all. Both the tax and the System that makes it possible should be abolished.

The political scientists who authorize this process of monetizing the national debt, and the monetary scientists who carry it out, know that it is not true debt. It is not true debt, because no one in Washington expects to repay it -- ever. The dual purpose of this magic show is simply to create free spending money for the politicians, without the inconvenience of raising direct taxes, and also to generate a perpetual river of gold flowing into the banking cartel. The partnership is merely looking out for itself.

Why, then, does the federal government bother with taxes at all? Why not just operate on monetized debt? The answer is twofold. First, if it did, people would begin to wonder about the source of the money, and that might cause them to wake up to the reality that inflation is a tax. Thus, open taxes at some level serve to perpetuate public ignorance, which is essential to the scheme. Thus, open taxes at some level serve to perpetuate public ignorance, which is essential to the success of the scheme. The second reason is that taxes, particularly progressive taxes, are weapons by which elitist social planners can wage war on the middle class.

EXPANSION LEADS TO CONTRACTION

While it is true that the Mandrake Mechanism is responsible for the expansion of the money supply, the process also works in reverse. Just as money is created when the Federal Reserve purchases bonds or other debt instruments, it is extinguished by the sale of those same items. When they are sold, the money is given back to the System and disappears into the inkwell or computer chip from which it came. Then, the same secondary ripple effect that created money through the commercial banking system causes it to be withdrawn from the economy. Furthermore, even if the Federal Reserve does not deliberately contract the money supply, the same result can and often does occur when the public decides to resist the availability of credit and reduce its debt. A man can only be tempted to borrow, he cannot be forced to do so.

There are many psychological factors involved in a decision to go into debt that can offset the easy availability of money and a low interest rate: A downturn in the economy, the threat of civil disorder, the fear of pending war, an uncertain political climate, to name just a few. Even though the Fed may try to pump money into the economy by making it abundantly available, the public can thwart that move simply by saying no, thank you. When this happens, the old debts that are being paid off are not replaced by new ones to take their place, and the entire amount of consumer and business debt will shrink. That means the money supply also will shrink, because, in modern America, debt is money. And it is this very expansion and contraction of the monetary pool -- a phenomenon that could not occur if based upon the laws of supply and demand -- that is at the very core of practically every boom and bust that has plagued mankind throughout history.

In conclusion, it can be said that modern money is a grand illusion conjured by the magicians of finance in politics. We are living in an age of fiat money, and it is sobering to realize that every previous nation in history that has adopted such money eventually was economically destroyed by it. Furthermore, there is nothing in our present monetary structure that offers any assurances that we may be exempted from that morbid roll call.

Correction. There is one. It is still within the power of Congress to abolish the Federal Reserve System.

SUMMARY

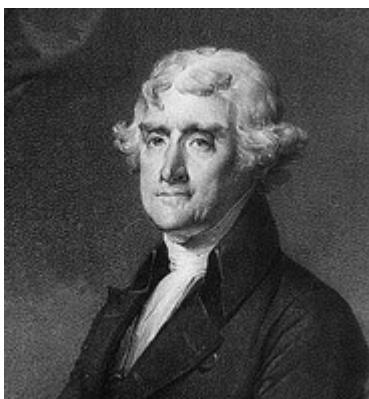
The American dollar has no intrinsic value. It is a classic example of fiat money with no limit to the quantity that can be produced. Its primary value lies in the willingness of people to accept it and, to that end, legal tender laws require them to do so.

It is true that our money is created out of nothing, but it is more accurate to say that it is based upon debt. In one sense, therefore, our money is created out of less than nothing. The entire money supply would vanish into the bank vaults and computer chips if all debts were repaid.

Under the present System, therefore, our leaders cannot allow a serious reduction in either the national or consumer debt. Charging interest on pretended loans is usury, and that has become institutionalized under the Federal Reserve System.

The Mandrake Mechanism by which the Fed converts debt into money may seem complicated at first, but it is simple if one remembers that the process is not intended to be logical but to confuse and deceive. The end product of the Mechanism is artificial expansion of the money supply, which is the root cause of the hidden tax called inflation.

This expansion then leads to contraction and, together, they produce the destructive boom-bust cycle that has plagued mankind throughout history wherever fiat money has existed.



If the American people ever allow private banks to control the issue of their money, first by inflation and then by deflation, the banks and corporations that will grow up around them, will deprive the people of their property until their children will wake up homeless on the continent their fathers conquered.

Thomas Jefferson

G Edward Griffin Creature From Jekyll Island A Second Look At The Federal Reserve [VIDEO BELOW](#)

<http://www.youtube.com/watch?v=bhMacPvc5qc>

The Capitalist Conspiracy - G Edward Griffin [VIDEO BELOW](#)

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